GA1.13: RCED-88-67

United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Regulation and Business Opportunities, Committee on Small Business, House of Representatives

January 1988

INTERNAL CONTROLS

COMPLETED
23

SBA's Controls for Identifying Defaulted Loan Applicants

GAO/RCED-88-67

Co. M. Ann

ORIGINAL

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-229421

January 21, 1988

The Honorable Ronald L. Wyden
Chairman, Subcommittee on Regulation
and Business Opportunities
Committee on Small Business
House of Representatives

Dear Mr. Chairman:

On May 29, 1987, your office asked us to determine what internal controls the Small Business Administration (SBA) has to identify loan applicants who have previously defaulted on an SBA loan. Your office expressed special interest in determining if SBA uses an automated system for identifying such applicants, or if such a system is needed because SBA is approving second loans for applicants who have previously defaulted on an SBA loan. In subsequent discussions, your office also asked us to determine whether SBA was exceeding the statutory dollar limits on loans to individual borrowers. On September 14, 1987, we briefed your staff on the results of our work and agreed to provide the information in a report to you.

In brief, we found that SBA relies on lending controls, such as information provided by the applicants and outside credit reports, to identify applicants who have previously defaulted on an SBA loan. Second, although SBA does not rely on automated controls to identify applicants who have previously defaulted on one of its loans, our analysis indicated that SBA has seldom made loans to such applicants and, therefore, it does not conclusively demonstrate that SBA needs to establish such controls. SBA officials, however, recognize that such controls are intuitively a sound idea and plan to study the feasibility and costs of automated controls to identify applicants who have previously defaulted. Finally, with respect to SBA's statutory limits, the results of our initial work indicated that, with one exception involving a legal interpretation of the law, SBA had not exceeded its statutory lending limits; thus, we decided that this area did not warrant further investigation at this time. Appendixes I through VII and table IV.1 present the details of our observations.

Background

The Small Business Administration provides businesses and individuals with financial assistance through various lending programs. SBA generally provides such assistance either through direct loans from the

agency or through its guarantee of loans made by commercial banks. Two SBA programs—its general business lending program, authorized by section 7(a) of the Small Business Act of 1953, and its Disaster Loan Program, authorized by section 7(b) of the Act—accounted for approximately 91 percent of SBA's outstanding loan portfolio in fiscal year 1986. As of fiscal year 1986, SBA's general business loan portfolio had a value of $10.8 billion and its disaster loan portfolio had a value of $4.3 billion.

SBA's "Policies and Procedures for Financing Function" points out that lending officials should assure that "All loans should be of such sound value or so secured as reasonably to assure repayment." Although SBA's policies and procedures do not prohibit it from lending to borrowers who have previously defaulted on an SBA loan, SBA will generally not consider an application from an applicant whose earlier loan resulted in a loss to the agency.

The Small Business Act, as amended, established $500,000 as the amount of loss that SBA can accept for 7(a) guaranteed loans to any one borrower at any given time. It also established $350,000 as the maximum amount SBA can directly loan to any one borrower at any given time. SBA's Standard Operating Procedures specify the statutory lending limits for the 7(a) and other lending programs.

SBA's Internal Controls

To identify applicants who have previously defaulted on an SBA loan, the agency primarily relies on information provided by applicants, credit reports, and the knowledge of its loan officers and participating banks about businesses and individuals who have borrowed through SBA financial assistance programs. SBA does not rely on automated controls to identify applicants who have defaulted on a previous SBA loan. SBA officials, based on their experience, do not believe that businesses frequently default and subsequently apply for other SBA loans.

Therefore, these officials told us, when we started our review, that it would not be cost effective for SBA to establish additional automated controls to identify such applicants.

We found that other lenders we contacted, for comparative purposes, rely to varying extents on automated controls to identify applicants who have previously defaulted on loans from their banks or agencies. Two major commercial lenders we contacted told us that they rely primarily

on the same types of controls as SBA to identify such applicants. However, two other major federal lending agencies we contacted are implementing additional automated controls to identify borrowers who have previously defaulted on loans from their agencies.

Incidence of Defaulters Obtaining Subsequent Loans

Because the varying extent to which other lenders rely on automated controls indicated differences of opinion about the need for such controls, we focused our analysis on determining if SBA was frequently lending to borrowers who had previously defaulted. Through a computer search of SBA loan files (as of June 30, 1987) that contained about 570,000 loan records with valid social security and employer identification numbers, we found 192 instances where SBA may have approved second loans for borrowers who had previously defaulted on an SBA loan. We also found, during our search of the loan files, an additional 105 cases where SBA may have approved second loans for borrowers who defaulted on their first loans 6 months or less after SBA approved their second loan.

SBA's Loans Within Statutory Limits

In order to determine if SBA has exceeded its statutory limit on loans, we focused our attention on a computer search of loans approved since June 1976 that were associated with 194,213 employer identification numbers. We found approximately 4,600 cases where SBA potentially could have exceeded its lending limits because of a variety of reasons, including multiple loans to a borrower where the total amount of the loans approved over a number of years exceeded the statutory limit SBA can loan to an individual at any given time. To determine whether this area warranted further investigation, we reviewed 30 randomly selected cases of the approximately 4,600 cases to determine if SBA had actually exceeded its lending limits in these cases. Our review showed that, with one exception, SBA had not exceeded its lending limits at the time it approved the loans either intentionally or through oversight. For example, we found that in multiple loan cases, the borrowers had sufficiently paid down the balances of earlier loans so that when SBA approved subsequent loans for the borrowers, it did not exceed its legal lending limit at any given time in these cases.

The one exception involved loans SBA approved in September 1983 to benefit one small business under its 7(a) loan program and its development company loan program that in the aggregate exceeded the limit for 7(a) loans. SBA's Office of General Counsel reinterpreted SBA's legal

authority for the above practice in December 1983. The Office of General Counsel decided that, as a result of amendments to the Small Business Act in August 1983, SBA could not commit funds through the development company loan and the 7(a) loan programs that benefited one small business and that exceeded the limit on 7(a) loans. SBA's Standard Operating Procedures are now consistent with the Office of General Counsel reinterpretation of its legal authority.

It is possible, because of the small size of our sample, that at the 95-percent level of confidence the statutory limits could have been exceeded, at most, in 11 percent of the approximately 4,600 identified cases.

Our Observations

Although a system of automated controls to identify SBA's prior experience with applicants is intuitively a sound idea, our analysis showed that SBA has seldom made loans to individuals who previously defaulted on SBA loans. Accordingly, our work did not conclusively demonstrate that SBA needs to expand its use of automated controls to identify applicants who have previously defaulted on one of the agency's loans.

We decided that the results of our work to determine if SBA was exceeding its statutory lending limits did not warrant further investigation at this time because, although our sample size was small, the cases we reviewed showed that SBA had not, with one exception, exceeded its lending limits.

Comments of SBA Officials

In discussing the results of our work, SBA officials, including the Director, Office of Business Loans, said that a capability to check applicants automatically against SBA's loan file could be an improvement in their internal controls. These officials told us that they are committed to investigating the cost and feasibility of establishing such a capability.

In carrying out our work, we held discussions with appropriate SBA, the Department of Housing and Urban Development, Farmers Home Administration, and commercial lending officials. We conducted a computer search of SBA's loan data to identify borrowers who obtained SBA loans either after defaulting on a previous loan or who defaulted on prior loans within 6 months or less of obtaining their subsequent SBA financing. We relied solely on information in SBA's loan files and did not validate the results of our search, nor did we seek additional clarification

about the cases we found from SBA because of their small number in relation to the universe size. We conducted another computer search of SBA loan data to identify potential cases where SBA may have exceeded its statutory lending limits. We reviewed a limited number of cases selected on a random basis in order to determine whether further investigation was warranted.

Our work was performed in accordance with generally accepted government auditing standards except for the previously noted areas. The scope of our review is discussed in more detail in appendix II.

We discussed the contents of this report with SBA officials. They concurred with the facts, and we have included their comments where appropriate. However, as agreed with your office, we did not obtain official agency comments. We are sending copies of this report to the Administrator, SBA; appropriate congressional committees and subcommittees; and other interested parties.

The major contributors to this report are listed in appendix VII.

Sincerely yours,

Sarah F. Jaggar

Sarah F. Jaggar
Associate Director

Contents

Letter		1
Appendix I Background		8
Appendix II Objectives, Scope, and Methodology		9
	Identifying SBA Controls	9
	Need for Automated Controls	9
	Lending Within Statutory Limits	11
Appendix III SBA Controls Over Loan Processing		12
	SBA Loan Processing Procedures	12
	SBA's Use of Automated Controls	13
Appendix IV Comparison of Processing Controls: SBA, Federal, and Nonfederal Lenders		15
	Commercial Institutions	15
	Federal Agencies	15
Appendix V Incidence of Subsequent Loans Approved After or Within Six Months of a Default on a Prior Loan		17
Appendix VI SBA Loans Approved Within Lending Limits		19

Appendix VII
Major Contributors to This Report

Resources, Community, and Economic Development Division, Washington, D.C. 21 21

Tables

Table IV.1: Comparison of Processing Controls: SBA, Other Federal and Nonfederal Lenders 16

Abbreviations

EIN	employer identification number
FMHA	Farmers Home Administration
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
OMB	Office of Management and Budget
SBA	Small Business Administration
SSN	social security number

Background

The Small Business Act of 1953 (67 Stat. 232) created the Small Business Administration (SBA) which obtains its present existence and authority from the Small Business Act (72 Stat. 384; 15 U.S.C. 63, et seq.), as amended. SBA offers small businesses financial assistance through various programs. SBA's major lending programs, which comprised 91 percent of SBA's total outstanding loan portfolio in fiscal year 1986, are the 7(a) program and the Disaster Loan Program. Through the 7(a) program, SBA either provides direct loans to small businesses or permits lending institutions to make loans to small businesses that SBA guarantees to repay if the borrower defaults. SBA is then obligated to purchase no more than 90 percent of the outstanding balance plus accrued interest. In fiscal year 1986, SBA had 120,096 general business loans valued at $10.8 billion.

Under the Disaster Loan Program, SBA makes direct loans to individuals and to businesses at favorable terms and conditions for uninsured losses of property, both real and personal, damaged by natural disasters. As of fiscal year 1986, SBA had outstanding 208,600 loans valued at $4.3 billion.

SBA administers its loan programs through its headquarters office, 10 regional offices, 96 district and branch offices, and 4 regional disaster centers. For example, the district offices review 7(a) loan application packages and approve or disapprove the applications.

Objectives, Scope, and Methodology

On May 29, 1987, the Subcommittee on Regulation and Business Opportunities, House Committee on Small Business, asked us to determine what controls SBA used to identify loan applicants who have defaulted on previous SBA loans. The Subcommittee was especially interested in determining if SBA used automated controls to identify such applicants. The Subcommittee was concerned that without automated controls SBA may lend to such applicants without knowing about their prior experience. Also, there was concern that, by lending to applicants who had previously defaulted, SBA could incur greater risk of loss than it would incur in lending to borrowers who have not previously defaulted. Therefore, the Subcommittee wanted to know, in the absence of an automated system, whether such a system is needed. The Subcommittee, in subsequent discussions, asked us to determine if SBA is exceeding the statutory limit on the amount it can lend to one borrower.

Our objectives in the review were to determine what controls, including automated controls, SBA uses to identify applicants who have previously defaulted on an SBA loan; the need for automated controls; and whether SBA is exceeding its statutory limits.

Identifying SBA Controls

To identify what controls SBA uses to determine if an applicant has previously defaulted on an SBA loan, we analyzed SBA documentation on loan processing, including SBA's Standard Operating Procedures for the Financing Function. We interviewed SBA headquarters staff, including the Deputy Associate Administrator for Financial Assistance; the Director, Office of Business Loans; the Director, Office of Portfolio Management; and the Director, Office of Information Resources Management. We also interviewed staff in SBA's Washington District Office, including the Chief, Portfolio Management; and conducted a telephone survey of staff, including Assistant District Directors for Finance and Investment, in 26 other SBA district offices to obtain information about district office controls and their views about the adequacy of controls.

Need for Automated Controls

To determine if SBA's controls are adequate, or if automated controls are needed, we conducted a computer search of SBA's active loan accounting file to identify borrowers who have received loans from SBA either after defaulting on a previous loan or within 6 months of defaulting. According to SBA officials, the active loan file contains all loans approved by the agency since its inception to the present except for loans that the

borrowers paid in full or which were fully cancelled, that is, not disbursed. For purposes of this study, we defined a default as the date SBA placed the loan in liquidation or charged it off.

We searched approximately 570,000 loan records with valid[1] social security numbers (SSN) or employer identification numbers (EIN) contained in SBA's loan accounting file in order to

- identify cases where more than one loan was associated with either a SSN or EIN,
- determine in cases of multiple loans if a first loan was in liquidation or charged off prior to SBA's approval of a second loan, and
- determine if SBA approved a second loan 6 months or less before it placed a first loan in liquidation or charged it off.

We did not verify that the computerized information accurately reflected the case facts nor did we ask SBA officials if they knew about previous loans when they approved second loans because of the small number of cases identified relative to the universe size. We did not test general or application controls of the systems that capture the data. We believe that the data were suitable for our use, but the results of our analysis must be interpreted with the above limitation in mind.

We identified 5,636 active loan records in our file which contained invalid/missing EINs and SSNs. This number of invalid/missing numbers automatically rejected out of our file could have had some effect on our analysis. For example, it could cause an understatement of instances where SBA may have approved second loans for borrowers who had previously defaulted on an SBA loan. In addition, missing EIN and SSN data could have caused an understatement in the total amount borrowed (due to multiple loans) for a given borrower.

To determine if SBA's controls are similar to those used by other lenders, we compared SBA's controls with the controls used by two major commercial lenders we contacted and the Department of Housing and Urban Development (HUD) and the Farmers Home Administration (FMHA).

[1]For the purposes of our review, a valid SSN or EIN is distinguished from an invalid number by a nonrepeating string of numbers. A string of repeating numbers such as 999999999 signifies an invalid number.

Lending Within Statutory Limits

We also conducted a computer search of SBA loans, grouped by borrowers' EIN, approved since June 1976 to determine if SBA exceeded its legal lending limits established for the 7(a) program in June 1976 of $500,000 for guaranteed loans and $350,000 for direct loans. We then randomly selected 30 of the approximately 4,600 cases that might have exceeded the lending limits identified through our computer search and checked SBA borrower history records and discussed the cases with district office loan personnel to determine if SBA had exceeded the lending limits.

SBA Controls Over Loan Processing

SBA Loan Processing Procedures

SBA officials told us that their loan processing controls for identifying applicants who have previously defaulted on an SBA loan include information provided by the applicant, credit reports, and the institutional knowledge of the SBA district offices and participating banks. For example, SBA's loan application requires the applicant to disclose previous government financing experience that he/she, or any of the business principals have had. SBA officials told us that they believe the perjury penalty of a $5,000 fine and/or a 2-year jail term for false application statements is a control for obtaining accurate disclosure statements from applicants.

SBA requires, as part of the application process, financial statements from (a) the proprietor of a sole proprietorship, (b) general partners, and each limited partner owning 20 percent or more of the business, (c) officers, directors, and additionally, holders of 20 percent or more ownership of the business, and (d) any person providing a guarantee on the loan. These statements provide information on outstanding liabilities, including those owed to SBA.

SBA obtains credit reports from outside credit reporting agencies such as DUN & BRADSTREET as another mechanism for identifying liabilities of a business.

Finally, SBA officials stressed the importance of the institutional knowledge of their district office staffs and participating banks in identifying applicants with prior SBA loans.

SBA officials told us that there is no written SBA policy prohibiting approval of loans to borrowers with whom SBA has previously incurred a loss. SBA officials also told us that they generally will not consider a loan application from an applicant that SBA has incurred a loss on except when the applicant has agreed to remedy the loss or in other extenuating circumstances.

Additional District Office Controls

As part of our review, we surveyed loan officers in 26 SBA district offices, including Assistant District Directors for Finance and Investment, to determine whether they used manual or automated checks that allow them to identify applicants who have had prior loans approved by the district office. Twenty of the offices indicated that they use either automated or manual checks of their records to determine if the applicant has had a prior loan approved by the district. The other six offices did not use such a check. Six of the 20 offices who told us that they use

a check, routinely use it. The remaining offices, for the most part, told us that they check their records on an exception basis when they have questions about the applicants. Eight offices indicated a desire for more thorough controls to check on applicants' previous borrowing experience with SBA. Twenty-four of the district offices cited the importance of institutional memory in identifying previous borrowers.

SBA's Use of Automated Controls

Regarding SBA's use of automated controls to identify applicants who have defaulted previously, SBA officials told us that the district offices have the capability to search the loan accounting file for the names of all borrowers who have names that sound like the applicants' in order to determine if the applicant has borrowed previously. SBA officials told us that the names in the accounting files are usually the business names of the borrowers and not necessarily the names of the principals of the businesses.

SBA officials also told us that SBA does not rely on an automated system to check the SSNs of principals of the business applicant in order to determine if they had prior loans with SBA. These officials told us, when we started our review, that they had not automated the names and SSNs of principals and guarantors of business borrowers because

- they did not believe individuals, who have previously defaulted, frequently apply for subsequent loans from SBA in different geographic areas, using different business names and SSNs,
- they have higher priorities for limited ADP resources, and because of
- the high cost of establishing such a data file.

SBA officials have since told us that they plan to study the feasibility and costs of automated controls for determining if an applicant has had prior SBA loans.

SBA's loan accounting file does not contain the names and SSNs of all principals of a business borrower or the guarantors of an SBA business loan. Additionally, SBA district offices do not have the capability to search SBA's loan accounting file by SSN.

SBA's loan accounting file does contain a data field for SSNs that applicants voluntarily supply to SBA as part of the application process. Officials in SBA's Business Loan Program said that they request that applicants provide SSNs to SBA, but they did not believe that they had the

legal authority to require applicants to provide them to SBA. Subsequently, however, SBA's Chief Counsel for Administrative Law told us that there is no legal restriction to SBA obtaining SSNs from principals or guarantors for the purpose of checking on prior SBA loans.

SBA has automated the names and SSNs of its disaster loan borrowers in order to comply with Office of Management and Budget (OMB) 1985 credit management guidelines that require agencies to report consumer debts that are owed to them to credit bureaus. SBA automated the names and numbers so that it could comply with credit bureau reporting practices. It cost SBA approximately $100,000 to establish the data base for approximately 200,000 disaster loans.

Comparison of Processing Controls: SBA, Federal, and Nonfederal Lenders

To determine if SBA should have automated controls to identify applicants who have previously defaulted on an SBA loan, we compared SBA's controls with those used by other major commercial and federal lenders. We found that these other lenders use automated controls to varying extents (see table IV.1).

Commercial Institutions

We found that the two major commercial lenders we contacted rely on the same types of controls as SBA, including disclosure statements by the applicants, financial statements of the applicants, outside credit reports, and the institutional knowledge of the bank. Neither bank relies on an automated system based on the names and SSNs of the principals and guarantors of corporate borrowers to determine if the bank has had prior experiences with them.

One of the banks we contacted is a large bankholding company. Bank officials told us that they do not maintain a master file of all borrowers from the bank and its subsidiary banks. Therefore, the bank would not know if an applicant had prior borrowing experience with a subsidiary of the bank unless the applicant disclosed the information about the previous loan or the information was disclosed in a credit bureau report. Bank officials told us that they did not believe it would be cost effective for the bank to establish a master file of borrowers from the bank and its subsidiaries because they did not believe that commercial borrowers frequently apply to the bank for loans after defaulting on a loan from a subsidiary bank in a different geographic area.

Federal Agencies

Other major federal agencies involved in lending programs that we contacted are establishing automated systems to identify their previous experience with applicants. Farmers Home Administration (FMHA) officials told us that they established an automated system using identification numbers, including SSNs, so that loan making officials can check to determine if the applicant has had a prior loan with the agency. FMHA officials cited field office concerns about applicants who have previously defaulted on a FMHA loan obtaining another loan as the reason for installing the system. The officials told us that start-up costs were $30,000 to automate 1.5 million loans. The system went on line in June 1987.

The Department of Housing and Urban Development (HUD) has established a system for its single family mortgage program, using applicants' SSNs so that participating banks can check them against a file of SSNs

associated with defaults and claims. HUD officials established this system in response to recommendations of a 1986 task force investigating allegations of abuse in the Single Family Program. HUD Single Family Program officials told us that it cost $50,000 to automate 1 million files. The system went into operation in August 1987. Officials in HUD's Multi-Family Program told us that they routinely conduct a manual search of their records to determine their prior experience with sponsors of multi-family projects. These officials told us that they plan to automate this information by 1989.

Table IV.1: Comparison of Processing Controls: SBA, Other Federal and Nonfederal Lenders

			HUD			
Control	SBA	FMHA	Single/Multi-family development programs		Nonfederal Lenders	
Business applicants' financial statements	x	x	n/a	x	x	x
Personal financial statements of principals	x	x	x[a]	x	x	x
Personal financial statements of guarantors	x	x		n/a	x	x
Applicant's statement of prior borrowing from lending organizations	x	x	x	x	x	x
Verification of information through credit reports	x	x	x	x	x	x
Automated matching of principal identifiers	b	x	x	c		
Lending organization's institutional knowledge about applicant	x	x	x	x	x	x

[a]Required when self-employed

[b]SBA has only automated the names and SSNs of Disaster Home Loan borrowers but not of all principals and guarantors on loans from the 7(a) loan program.

[c]HUD manually checks on its prior experience with sponsors of multi-family projects. According to HUD officials, the process will be automated by 1989.

LEGEND
"x" denotes that controls are used
Blank spaces denote that controls are not used

Incidence of Subsequent Loans Approved After or Within Six Months of a Default on a Prior Loan

Our analysis showed that although it does not rely on automated controls to identify applicants who have previously defaulted on an SBA loan, SBA has seldom made loans to borrowers who have previously defaulted on one of its loans. Specifically, through a computer search of approximately 570,000 loan records, we found 192 cases where SBA may have approved loans for borrowers who previously defaulted on an SBA loan. We also found an additional 105 cases, among the approximately 570,000 loan records, where SBA may have approved loans for borrowers who defaulted on their prior loans 6 months or less after SBA approved their subsequent loans.

We searched approximately 570,000 loan records with valid SSNs and EINs contained in the active loan accounting file to identify borrowers who had loans approved by SBA after defaulting on a prior loan. According to SBA officials, the active loan file contains all loans approved by the agency since its inception to the present except for loans borrowers have paid in full and fully cancelled loans, that is, not disbursed.

For purposes of this analysis, we defined a defaulted loan as one that SBA has transferred to liquidation or has charged off. We also reasoned that SBA does not generally transfer a delinquent loan immediately to liquidation or charge it off and that borrowers may be obtaining additional SBA loans while they are delinquent on a prior SBA loan. Therefore, we also searched the data to identify borrowers who had an additional SBA loan approved 6 months or less before they defaulted on their prior SBA loans.

We found 192 cases in which SBA may have approved loans for borrowers after the borrowers had defaulted on a prior loan. We found an additional 105 cases where SBA may have approved loans for borrowers who defaulted on their prior loans 6 months or less after SBA approved the additional loans.

We did not validate any of the above cases because of their small number relative to the universe size. Therefore, it is possible that cases we identified may not actually involve the same borrowers because of errors in SSNs and EINs contained in SBA's loan accounting file. We also cannot state that the cases indicate any weakness in SBA's internal controls, without validation, because SBA district offices may have been aware of the prior defaults or delinquent status of loans but decided to approve subsequent loans because of other considerations. For example, SBA may approve a second loan for a business after it previously defaulted if the borrower agreed to remedy the default.

We analyzed the distribution of loans approved after prior defaults or within 6 months of the defaults to determine how frequently the same SBA office approved both the prior and subsequent loans. We found that in 70 percent of the cases where SBA approved a loan for a borrower after the borrower had defaulted on a prior loan, the same office approved both loans. We found that in approximately 86 percent of the cases where SBA approved a loan for a borrower who defaulted on a prior loan within 6 months of the additional financing, the same office approved both loans.

The fact that the majority of cases we identified involved loans approved by the same SBA offices appears to support SBA's position that borrowers are not frequently defaulting and moving to different geographical areas to obtain loans from other SBA offices.

SBA Loans Approved Within Lending Limits

Our analysis to determine if SBA is exceeding its legal lending limits indicated that, with one exception involving a legal interpretation of the law, SBA had not exceeded its statutory lending limits.

We searched SBA's loan accounting files using the current lending limits established in June 1976 for the 7(a) business loan program. The Congress, at that time, established $500,000 as the amount of total exposure to loss that SBA can accept for 7(a) guaranteed loans to any one borrower at any given time. The Congress also established $350,000 as the maximum amount SBA can directly loan to any one borrower at any given time.

We searched SBA's loan accounting files by applying the above lending limits to all loans SBA approved since June 1976 to borrowers grouped by their EINs. We included only EINs in our analysis in order to complete our work within the agreed to time frames. There were 194,213 loans with valid EINs in our universe.

We found 4,638 cases where SBA could have potentially exceeded the limit because either it had approved multiple loans for a borrower over a number of years and their total exceeded $500,000, or the amount of an individual direct loan exceeded $350,000 which is the amount that SBA can approve for a direct loan through its regular business program.

We randomly selected 30 cases and found that, with one exception, SBA had not exceeded its legal lending limit in these cases.[1] We found 21 cases involving multiple loans where (1) loans were either fully cancelled, paid in full, or paid down prior to SBA approving additional loans so that the additional loan amounts did not cause SBA to exceed its lending limits, (2) loans were approved under different lending programs financed through different funds so that separate limits applied, or (3) the proceeds of subsequent loans were used to pay off the first loan's outstanding balance.

In eight other cases, we found that the loans were approved under lending programs other than the 7(a) program that have higher direct loan limits such as the Disaster Loan Program which allows SBA to make direct loans of $500,000, or more in exceptional cases.

[1]Based on our sample, it is possible, at the 95-percent level of confidence, that the statutory limits could have been exceeded, at most, in 11 percent of the approximately 4,600 identified cases.

In one other case, we noted that SBA had, in September 1983, approved two loans to benefit one small business using two separate financial assistance programs. SBA approved a $450,000 loan under its 7(a) program and a $500,000 loan under its development company financing program to assist the same small business. However, SBA's Office of General Counsel decided in December 1983 that, as a result of amendments to the Small Business Act in August 1983, that SBA could no longer commit funds from these programs (both financed through SBA's Business Loan and Investment Fund) that benefited the same small business and that exceeded the limit on 7(a) loans. SBA officials told us that prior to the General Counsel decision, it had been an accepted practice of the agency to combine loans from the two separate programs as a way to assist businesses that needed more funds than could be provided under the limit imposed on each individual program.

The Director, Office of Business Loans, told us that some SBA district offices continued to approve loans that benefited the same borrower using the two separate programs that in the aggregate exceeded $500,000 after the General Counsel decision because they were not aware of it. He also told us that the decision is now clearly understood and the district offices are not approving such loan packages. We noted that SBA's Standard Operating Procedures for the Financing Function currently states that the $500,000 limit applies to all loans approved from the Business Loan and Investment Fund regardless of the program source.

Major Contributors to This Report

Resources, Community, and Economic Development Division, Washington, D.C.

Sarah F. Jaggar Associate Director, (202) 275-1000
Stephen L. Keleti, Group Director
George W. Collard, Assignment Manager
William J. Mohan, Evaluator-in-Charge
Catherine Lojewski, Evaluator
Sandra Emrick, Computer Programmer

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.